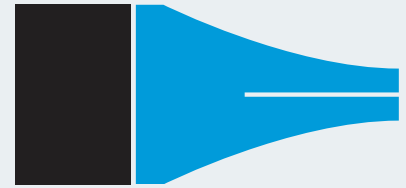


Real life examples of problematic variation clauses

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Trust deed variation clauses vary from trust to trust – this article gives examples of some of the problematic ones we've seen.

Introduction

There are a number of reasons why the trust instrument of a discretionary trust might need to be amended. These include, but are not limited to, succession planning, tax planning and/or the general modernisation of the provisions of a trust deed to account for changes in trust and tax laws.

A common reason for varying a discretionary trust deed is to bring the deed in line with the High Court decision in *FCT v Bamford (Bamford)*,¹ which clarified the ability to define income for the purpose of the trust, and the introduction of the trust streaming provisions into the *Income Tax Assessment Act 1997 (Cth) (ITAA97)*.² Consequently, discretionary trust deeds are often amended to provide for the streaming of income and the power of the trustee to separately categorise income and capital. This article examines examples of variation clauses and whether or not a variation to categorise and stream income and capital can be validly made.

It is important to remember that the variation clause, and the trustee's powers more generally, should not be looked at in isolation. Therefore, variation clauses (like all clauses) should be read in the context of the trust deed as a whole.

What provisions should be included in a trust deed following Bamford?

A trustee may wish to include the following powers in any trust deed as a result of *Bamford* and the ITAA97 streaming amendments:

- to allow the trustee to determine the income for any given accounting period;
- to separately record and categorise income and capital;

- to selectively stream distributions of capital gains and franked distributions to beneficiaries; and
- to set aside any income or capital for any particular beneficiary on sub-trust subject to the terms of the original trust.³

Trusts, powers and provisions

It is the trust instrument that determines the rules of the trust. Therefore, in order to vary the provisions of a trust deed, the variation power itself, as contained in the deed, must be considered. Variation clauses can be quite wide or narrow depending on the terminology and phrasing used. The difficulty often lies in the distinction between “trusts”, “powers” and “provisions”. This distinction has been discussed in detail in a number of recent publications.⁴

The term “trusts” refers to core provisions of the trust deed such as the class or classes of beneficiaries of the trust and their entitlements.⁴ The term “powers” refers to all decisions to be made by the trustee, and the term “provisions” refers to all of the clauses in the deed including the powers and trusts.

A variation of a trust deed to empower the streaming of income, as discussed above, would generally fall under the “powers” and “provisions” categories. However, an amendment to effect income streaming would arguably not constitute an amendment to a “trust”.

Consequently, if the variation power in the trust deed only allows for trusts to be amended, there may be some difficulty in incorporating the required clauses into the trust deed.

Practical examples of variation clauses

Below are examples of variation clauses that the authors have encountered when preparing variations in line with *Bamford* and the streaming amendments.

Example 1

“The Trustee may at any time and from time to time by Deed:

- (a) Vary the Trusts hereby declared by appointing in favour of any child or children and/or other issue of the Appointor in addition to or in substitution for the said Beneficiaries or in addition to or in substitution for any person or persons in whose favour the Trustee may so appoint whether or not any such child or children or other issue have previously been deemed to be a Beneficiary and if more than one in such shares as the Trustee in its absolute discretion thinks fit and/or;”

This is a very restrictive variation clause and in fact doesn't allow for any variation of the trust deed other than to make “appointments” in favour of certain children. We suspect that this was an attempt to draft an appropriation clause. In the authors' view, this clause does not enable to the trustee to make amendments to the trust deed to include powers to categorise and stream income and capital gains.

In this scenario, alternative options to consider could include: whether streaming can be effected through other means; seeking a declaration from a court that the variation power be widened; looking at winding up the trust; or transferring the assets to a new trust.

Example 2

“THE Trustee [sic] or other of the Trustee for the time being of the Trust hereby created may at any time and from time to time by Deed vary the trusts hereby declared [sic] new or other trusts in favour of any child or child or children or other issue of the said principal in addition to or in substitution for any of the existing trusts of the Trust Fund and of the income therefrom.”

This variation clause is limited to only varying the “trusts” of the trust and does not expressly extend to “powers” or “other provisions”. In addition, it is uncertain whether amendments to the “trusts” can only be made if they are in “favour of any child”. In the authors’ view, it is arguable that this clause will not enable the trustee to make amendments to include powers to categorise and stream income and capital gains.

Example 3

“The Trustee for the time being may at any time and from time to time by deed of appointment or other deed revoke add to or vary all or any of the trusts hereinbefore limited or the trusts limited by any variation or alteration or addition made thereto from time to time and may by the same or any other deed or deeds declare any new or other trusts or powers concerning the Trust Fund or any part or parts thereof the trusts whereof shall have been so revoked added to or varied but so that the law against perpetuities is not thereby infringed and so that such new or other trusts powers discretions alterations or variations:

- (i) may relate to the management or control of the Trust Fund or the application or investment thereof or to the Trustee’s powers or discretions in these presents contained;
- (ii) shall not be in favour of or for the benefit of the Settlor or result in any benefit to the Settlor but shall otherwise be for the benefit of all or any one or more of the General Beneficiaries hereunder or, if there shall be none, for the benefit of all or any one or more of the statutory next of kin of the last surviving Primary Beneficiary;
- (iii) shall not affect the beneficial entitlement to any amount set aside for any beneficiary prior to the date of the variation alteration or addition.”

This type of variation power is very common in older deeds. Under this variation clause, the trustee may vary the “trusts” of the trust and declare any new powers. However, the trustee cannot amend the existing powers of the trust, which would generally include the income and categorisation clauses of the deed.

Therefore, in order to add a power to categorise and stream income and capital,

a deed of declaration of new powers could be prepared. In that deed, the trustee would declare new powers that empower the trustee to categorise income and capital of the trust and for such amounts to be streamed. The old income powers (that are not “trusts”) cannot be amended, but a clause could be added to ensure that the newly declared powers are to take precedence over any other provisions in the deed.

It is important to note that this variation power only applies to “trusts” and “powers” and does not extend to other provisions of the trust deed. For example, the provisions in the trust deed relating to the appointor or the guardian could not be amended or added under this clause.⁵

Example 4

“23.1 Subject to the provisions of sub-clauses 23.2 and 23.3 the Trustee may at any time and from time to time prior to the Termination Date with the written consent of the Appointor (if any) for the time being by deed:

- 23.1.1 alter add to vary or revoke any trust or provision herein limited or contained in this Deed as the case may be other than this clause; or
- 23.1.2 appoint and resettle the Trust Fund or any part thereof and the income to arise therefrom in the manner and upon the trusts subject to the conditions and in the proportions and with such powers and to such ends intents and purposes to or among such one or more of the Beneficiaries as the Trustee may from time to time think fit.

23.2 No alteration addition variation or revocation referred to in sub-clause 23.1 shall have the effect of diverting or modifying a vested interest of a Beneficiary in the income or capital of the Trust Fund or the investments representing the same or income derived from any such investment to which such Beneficiary has become absolutely entitled pursuant to this Deed.

23.3 No alteration addition variation or revocation referred to in sub-clause 23.1 shall infringe any applicable law or rule against perpetuities or relating to remoteness of vesting or the period during which income of the Trust Fund may be accumulated or otherwise extend the Termination Date or result in any provision of this Trust becoming void.”

This variation clause is very wide and flexible. It allows for the variation of all provisions in the trust deed, which would include the income streaming and categorisation powers. In addition, it would extend to varying other provisions of the trust deed such as the provisions relating to the appointor or the guardian. However, it is important to note that, under this variation clause, the appointor’s consent would be required to authorise any such variation.

Conclusion

When considering whether to vary a trust deed, it is important to review the variation clause carefully to ensure the trustee has the necessary power to make the proposed amendment and to determine how that amendment must be effected. The variation clause should not be viewed in isolation but rather should be read and reviewed in the context of the trust deed in its entirety.

It may be that following such review, it is determined that the trustee does not have the necessary power to make the variation. If that is the case, alternative measures may need to be considered.

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References

- 1 [2010] HCA 10.
- 2 As introduced by *Tax Laws Amendment (2011 Measures No. 5) Act 2011* (Cth).
- 3 This could be used in order to set up a sub-trust under PS LA 2010/4.
- 4 For example, see Jorgensen R, “Managing trust deed amendments”, 2016 *Western Australia Tax Intensive*, The Tax Institute, 29 April 2016.
- 5 *Mercanti v Mercanti* [2015] WASC 297.